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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

6 January 1984

MEMORANDUM FOR: Charles V. Boykin
Deputy Assistant Secretary for Intelligence
Department of Energy

FROM: [redacted] 25X1
Chief, Strategic Resources Division
Office of Global Issues

SUBJECT: West European Gas Market: Frustrations for the Soviets [redacted] 25X1

Attached is our assessment of the West European gas market and recent Soviet marketing efforts. If you have any questions, please call me [redacted] 25X1

[redacted] 25X1

Attachment:
West European Gas Market: Frustrations for the Soviets
GI M 83-10286C, January 1984 [redacted] 25X1

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SUBJECT: West European Gas Market: Frustrations for the Soviets

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6 January 1984

West European Gas Market: Frustrations for the Soviets

Summary

Reduced natural gas demand and a surplus of available supplies have sharply reduced West European willingness to buy Soviet gas in this decade. To date, the Soviets have been able to sell only about half of the amount of gas envisioned when discussions began with West European purchasers in the late 1970s. As a result, Moscow has undertaken a concerted gas marketing effort by cutting prices, tying sales of West European equipment to gas purchases, and attempting to penetrate new markets--an effort which has the potential to limit access of other suppliers to the European market. With the exception of Italy, however, prospects for major additional contracts for Soviet gas in the next few years are poor. Nonetheless, Moscow is still well-placed to capture any growth in European demand in the 1990s. [redacted] 25X1

This memorandum was prepared by [redacted] *Energy Issues Branch, Office of Global Issues. The information contained herein is updated to 6 January 1984. Comments may be directed to* [redacted] *Chief, Strategic Resources Division,* [redacted] 25X1 25X1 25X1

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West European Gas Market: Frustrations for the Soviets

Gas Demand: Diminished Expectations

Lowered prospects for economic growth, together with rapid escalation of European gas prices since the late 1970s, have reduced sharply prospective West European gas demand. Government and industry demand projections for 1990 have been trimmed by nearly 20 percent since 1980. In addition, projections of indigenous European gas production are more optimistic. According to the US Embassy, Rome plans to maintain existing production levels--boosting 1990 Italian production estimates by over 60 percent compared with earlier projections--and the Netherlands, Western Europe's largest gas supplier, recently authorized additional gas exports of 10-15 bcm per year. Lowered demand estimates, combined with rising supply availability, have reduced West European net gas import demand in 1990 by about 20 percent compared with projections made only last year. In light of current supply contracts with the USSR, Algeria, and Libya, we believe the West Europeans now face a potential supply surplus of 5-10 bcm in 1990, forcing purchasers to take only the allowable minimum level from some contracts or shut in domestic production. [redacted] 25X1

Pressures on the Soviets

Lowered projections of West European gas imports have diminished the potential volume of gas the Soviets can sell. As originally planned, the Siberia-to-Western Europe gas pipeline was to have carried 40 billion cubic meters (bcm) of natural gas annually--worth then about $7 billion. The pipeline, however, was scaled back to 29 bcm of deliverable capacity in early 1981, in part reflecting weaker gas demand and Soviet efforts to speed completion of the project. At present, the Soviets have lined-up firm contracts with the West Germans, French, Swiss, and Austrians for only around 20 bcm. The Dutch and Belgians have dropped out as potential purchasers and an Italian agreement, which still has to be formally approved, will probably be for far less gas than the Soviets originally expected (Table 1). [redacted] 25X1

On the price front, Moscow faces lower gas prices and hence lower potential hard currency earnings.[1] The recent decline in oil prices to which gas prices are tied has prompted purchasers

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to request a review of the pricing provisions in their contracts. Unless oil prices rebound, Moscow could be forced to lower prices still further. French and West German purchasers are presently seeking cuts in the base contract price of new Soviet deliveries, with Paris reportedly demanding a 10 percent reduction. [redacted] 25X1

Soviet Overtures

Faced with reduced sales prospects in most major West European gas markets, the Soviets have mounted an extensive marketing campaign to promote gas sales to Italy and Finland and to penetrate markets in Sweden, Greece, and Turkey.

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- The Soviets have also offered to sell Finland and Sweden 3 bcm of natural gas annually by extending the current pipeline network in Eastern Finland to Helsinki and then across the Baltic to Galve near Stockholm. To entice the Finns and Swedes, the Soviets have marked gas prices down to near parity with coal. Moscow is also pressing the Finns to buy additional gas as a means of closing the bilateral trade gap. [redacted] 25X1

- In the south, Moscow has been pressing Greece to import Soviet gas via an extension of the Soyuz pipeline from Bulgaria. [redacted] 25X1

[redacted] 25X1

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Only Partial Success For Moscow

We believe lowered projections of gas demand, surplus supplies, and high costs for gas infrastructure development will largely thwart Soviet gas marketing efforts during the next few years. Still, with the world's largest gas reserves and low production costs, Moscow's hard currency needs and its desire to limit other suppliers will almost certainly prompt the Soviets to make offers to some West European countries which they would be hard pressed to refuse. Some additional sales will be made if Moscow cuts prices substantially but overall sales to Western Europe through the 1980s will remain well below what the Soviets would like. [redacted] 25X1

Italy. [redacted] 25X1
[redacted] Italy could defer new purchases of Soviet gas until at least the early 1990s. Even if Rome signs for Siberian gas because of political and trade considerations, we believe the volume will be far below the 8 bcm originally agreed upon--probably in the range of 3-6 bcm--and a lower base price will likely be negotiated. [redacted] 25X1

Finland. Soviet sales efforts in Finland appear stymied by price factors. A Finnish Trade Ministry report completed this summer calls for a lower Soviet gas price to offset the large capital investment required to extend the existing pipeline to Helsinki--estimated at $140 million. Potential demand, moreover, has been cut to only 1 bcm, down by one-third compared with earlier projections issued this summer. Still, a dramatic price cut could get the project moving, according to US Embassy reporting. [redacted] 25X1

Sweden, Turkey, Greece. Although these countries are considering gas imports, they presently have no significant internal gas distribution networks. As a result, we believe high infrastructure development costs will likely make Soviet gas an uneconomic proposition unless Moscow moves to cut prices further to help offset high development costs.

- Sweden has already encountered major obstacles in developing the infrastructure to absorb 440 million cubic meters annually of contracted Danish gas supplies slated to arrive starting in 1985. According to press reports, the Swedish state oil firm, Svenska Petroleum, has even called for the project to be abandoned because of huge potential losses.

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- In Turkey, the need to spread high infrastructure costs over thinly-populated residential and industrial bases would appear to make Soviet gas financially unattractive.

- [redacted] Greece will drag its feet on implementing any political pledge to purchase Soviet gas because of high infrastructure development costs. Moreover, [redacted] significant gas imports would only be cost effective if gas penetrated the residential sector, which would require that gas be sold at a 30-40 percent discount compared with competing fuels. This would require a Soviet contract price even lower than the $3 per million BTU recently mentioned. [redacted] 25X1 25X1 25X1

Gas Security Implications in the 1990s

Even if Moscow fails to win major additional sales in the 1980s, Moscow's marketing efforts will help set the stage for a major new encroachment in the 1990s. Specifically, Soviet willingness to cut prices will delay or prevent development of additional new supplies. If alternative gas projects are not undertaken in the next few years, supplies will not be available in the early 1990s when forecasters expect West European demand to grow. Without competing alternative supplies, the Soviets would be well-placed to capture an even greater share of the West European gas market in the 1990s. [redacted] 25X1

Price Cutting. Moscow's recent pricing practices portend stiff competition for other suppliers in the European market. In attempts to negotiate gas deals with the Finns, Swedes, and Greeks, the Soviets have shown a willingness to sharply cut gas prices to near parity with coal and heavy fuel oil. With Soviet energy sales accounting for over two-thirds of Moscow's hard currency earnings and with gas expected to partially replace oil in this trade, the Soviets will probably continue to undercut any competition. In addition, the very surplus implicit in contracted European gas supplies during the 1980s, which is weakening prices and stymying present Soviet sales efforts, could also prevent or delay development of several other gas export projects such as the Norwegian Troll field. Should these projects be delayed or fail to materialize the Soviets would be in position to capture a greater share of the West European gas market in the 1990s. [redacted] 25X1

Tied Sales. The prospect of granting lucrative Soviet equipment contracts in return for gas purchases could put further pressure on West European countries to purchase Siberian gas in the 1990s. [redacted] 25X1 25X1

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Barriers to Entry. If Soviet price cutting resulted in new gas sales to Sweden, Greece, or Turkey, Moscow could also be in a position to limit access of potential suppliers to the European market. An extension of the Finnish gas pipeline from the Soviet Union into Sweden would likely dampen any Swedish interest in financing and building a gas pipeline from the Norwegian Troms field to the continent. Such a pipeline through Sweden is one alternative for bringing around 25 bcm of northern Norwegian gas annually to the European market in the 1990s when it could be used to limit dependence on Soviet supplies. Without Swedish participation in either financing or purchasing some of the gas, such a project would be more costly. A gas pipeline from Troms through Norway, rather than Sweden, would cost an additional 10 percent just because of construction factors, [redacted] 25X1

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An extension of the Soviet pipeline network into Greece or Turkey could effectively block access to the European market by suppliers in the Middle East, where 45 percent of world non-Communist gas reserves are located. Markets in Turkey and Greece are key steppingstones for suppliers in the Middle East to enter the larger West European market because Middle-East suppliers will need to sell gas in transit to minimize the cost of delivery. By attempting to expand sales of its own gas to potential customers in Greece and Turkey, Moscow no doubt hopes to minimize the potential threat from Middle East suppliers. Following extensive press reporting of a potential Iran-Turkey gas deal, Moscow signed a joint protocol in Istanbul setting up a pipeline feasibility study on the export of gas from the USSR to Turkey. Iran--with the world's second largest gas reserves--has since abandoned all gas export projects in its present Twenty-Year Plan and all gas production is slated for domestic consumption. According to US Embassy reporting, aside from financial and technical obstacles of a major Iranian export pipeline, the Iranians are generally concerned about antagonizing the Soviets by constructing a competing pipeline project.

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Table 1

Western Europe: Projected Soviet Gas Deliveries

(billion cubic meters)

	1982[a]	1985	1990	2000
Existing Contracts	27.8	26.9	26.9	26.9
Austria	3.0	2.5	2.5	2.5
France	4.1	4.0	4.0	4.0
Italy	9.3	7.0	7.0	7.0
West Germany	10.6	12.0	12.0	12.0
Finland	.8	1.4	1.4	1.4
New Contracts (Urengoy)		7.2	17.5-21.7	17.6-21.8
Austria		1.0	1.5	1.5
France[b]			6.4-8.5	6.4-8.5
West Germany[b]		6.0	8.4-10.5	8.4-10.5
Switzerland			.4	.5
West Berlin		.2	.8	.8
Potential Contracts			10.0-13.0	12.5-15.5
Italy[c]			3.0-6.0	3.0-6.0
Finland			1.0	1.5
Sweden			1.0	1.5
Greece			2.0	4.5
Turkey			2.0	2.0

a Actual trade

b The range takes into account that amounts of annual offtake under the new contracts are subject to reduction by up to 20 percent under scheduled semiannual negotiations with the Soviets.

c We have assumed that any Italian-Soviet contract will be for far less than the 8 bcm origianally agreed upon.

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Table 2

Natural Gas Export Prices, 1983[a]

(US $ per million BTU)

Exporter	Price	Comment
Algeria	5.00-5.25	Price of LNG to European ports, c.i.f. including regasifaction costs
Netherlands	3.70-3.80	Price at Dutch border
Norway	3.80-3.90	(Ekofisk)
	4.50-4.70	(Statfjord) Estimated price at West Germany, c.i.f.; gas will not begin flowing until 1985 or 1986.
USSR	4.00	Base contract price for minimum volumes. Purchases above either the minimum or 80 percent of the contracted amounts are discounted.

[a] Price per million BTUs can be converted to price per barrel crude oil equivalent by multiplying by 5.62.